Comment on the paper "Economic Orthodoxy *versus* Social Development? The Dilemmas Facing Brazil's Labor Government" by E. Amman and W. Baer

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Professors Amman and Baer analyze the Labor experiment in Brazil 2003-2005, led by the Administration of President Lula da Silva and his Workers' Party (PT – Partido dos Trabalhadores). In the first part, the authors describe the PT's program prior to the presidential election of 2002 and they point out its emphasis on social goals, particularly concerning equity and redistribution. Secondly, they give an account of the macro-economic developments since the beginning of 2003 till the first half of 2005, showing the effects of economic policies actually followed by the new government. Under this framework, they highlight the contradiction between the previous program of social policies and the practice when Lula da Silva and the PT became responsible for the Brazil's government. In the final part of the paper, the authors adduce their arguments about the process and the strategic choices in the field of economic policy, made by the Lula's government. In particular, they doubt on the compatibility between orthodox measures and the implementation of social policies, and think that the chosen sequence was not a good one. Basically, this would lead, first, to macroeconomic control through orthodox policies, - like high interest rates, primary fight against inflation, budgetary balance or even surplus, and to let the exchange rate fluctuate even when it goes upwards - and only, in a later step, trying to achieve significant social improvements like large redistribution measures in favor of the poor, excluded people and underpaid workers.

The paper is well documented and has quite relevant and updated information on key social and economic indicators over the period under analysis. Moreover, it openly brings up the major economic dilemmas of similar labor political experiences (like that "opposing" growth and redistribution), and to some extent, also of many developing countries that have tried to upgrade their economic and social status, as shown in the literature references. Based on their deep knowledge of the Brazilian economy, particularly at its present stage, the authors provide a subtle analysis of this issue and related topics.

Although I agree with many points raised in the paper, I would not be so critic of the strategy adopted by Lula’s government so far. It is true that from the growth rate point of view, even if we consider the slight recession of the initial year as caused by factors that the new government couldn’t control - financial turbulence and exchange overshooting of 2002 and their consequences on the real economy -, the Brazilian performance has been modest (annual growth rate of 4.9% in 2004, and estimated around 3% in 2005 up to October; source IBGE/IPEA) and lags far behind the Asian giants like China or India. But the present Brazilian case has a lot of peculiarities, and needs to be put in a historical context, bearing in mind not only the evolution of Latin America during the last decades, but also other previous Labor Government experiences in different parts of the world. Moreover, Brazil under Lula’s government gains a new light if it is analyzed focusing on long term considerations rather than short term ones. Afterwards, in relation to the paper of Professors Amman and Baer, I draw attention to the main aspects that, in my view, must be considered for a complete and more balanced appraisal of this experience.

1. After a virtual eclipse in the 1990s, the decade of 2000 is clearly witnessing a return in Latin America of governments' activist programs regarding social policies and reforms. These new experiments, however, gain if they take into consideration the outcomes of similar historical attempts in Latin America and elsewhere, like those of Allende's Chile 1970-73, Argentina 1973-1976, Portugal 1974-75. Of course, we live in different times, but their main lessons should not be underestimated, particularly with regard to their economic rationale. In all of them, the immediate and large "social conquests" were quickly eroded within a few years if not in a shorter time, through rising inflation and in the middle of huge macroeconomic imbalances (in external and public accounts). Sometimes, in the very beginning, a surge in growth led by booming popular consumption, proved to be ephemeral, and effectively triggered the disequilibrium process.

In historical retrospect, among others, I could remember the case of France's socialist government of 1981 that, despite not so dramatic outcomes as in the three previous examples, had to change its planned policies within approximately two years. I should also recall that even in Brazil, the first government of Getúlio Vargas (1930-1945) with its relatively generous social policies for wage earners has proved to be the start of a long period of uncontrolled inflation and hyperinflation that plagued the country during several decades.

Therefore, even if redistribution is all the more desirable for Brazil, we cannot fall into the illusion of a rapid egalitarian change in income distribution, particularly under a democratic regime, and in a market environment. In spite of some temporary satisfaction, more or less generalized, at the initial stage, later on, tensions would rise at several levels eventually leading to a collapse of the process. Good intentions are not a good adviser for Labor governments engaged in deep social policies. Thus, refuting to embark in such a path, Lula's government made a wise decision and a step forward and probably, in the long run, conveyed a way for a consistent social improvement in the situation of the large Brazilian masses.

Concluding this point, it should be stressed that the government of Lula da Silva has demonstrated a sense of realism in a central issue of its program, accepting that social reforms need a sound macroeconomic foundation. Moreover, so far, it has conducted this policy in a credible way, and within a coherent model.

2. One of the main questions in this context is redistribution itself, particularly through legislation. Let's look first at the case of a minimum wage increase. In a situation of high unemployment (open plus hidden; see table 4, c) and d)), as is currently the case of Brazil, a substantial rise in the minimum wage will very likely boost unemployment even more (as happened in Portugal in the 1970s). Moreover, the introduction of rigidity in the labor market in response to rising unemployment - for example, limiting lay-offs - is not a satisfactory solution. Thus, a cautious policy in this domain seems much more desirable.

As far as concerns a real wages' increase it has essentially to be supported by improvements in productivity, since otherwise they will fall again. A strategy of higher wages and salaries not proportional to productivity is perhaps tenable for a while in a background of extensive and articulated structural reforms (higher wages will pick up productivity), but this seems not yet to be the case of Brazil. Hence, a long-term policy stimulating the factors leading to greater productivity would be a much clever step in order to reach a sustained increase in real wages.

In these circumstances, instead of rapid higher wages the preference for the reduction of unemployment seems quite appropriate, and the Lula's government can be credited of some success in this field (for example, the rate of total unemployment in São Paulo decreased from 20.6% in March 2004 to 16.9% in October 2005; source DIEESE).

Regarding the case of social expenses, *Fome Zero* and similar measures, Professors Amman and Baer themselves recognize that there is bad administration and insufficient knowledge of the field. Under these circumstances, a substantial increase in this kind of public spending risked to be a waste in a country that has not so many resources, and very likely would not help the people who need more (as the case of social security before the reform of 2003 proves well). All in all, it seems not to be a mistake to rethink these programs in order to target better the social objectives.

3. Lula's government is not clearly a free market advocate one. It maintains a high level of State intervention (much higher than Mexico, Argentina or Chile), raised taxes, and stopped the privatization process launched in the 1990s. In addition, official regulatory agencies imposed social obligations in some sectors, especially to firms of public utilities. It may be observed how these situations tend to last for a long time, and are often used to increase quantitatively the level of State intervention.

Professors Amman and Baer argue that orthodox measures will increase the weight of non-discretionary expenses (payments of the debt service, federal transfers to the States), and, as discretionary expenses are well defined by the Constitution, there will not be enough room to find public financial resources for investments in social programs, education and infrastructures. For tackling this issue one should take into account that the Brazilian economy underwent a major change in the last years, and in 2004 for the first time, since long ago, it grew with low inflation in so far its annual rate has gradually declined from 12.5% in 2002 to 5.9% in 2005 up to October (source FGV/Banco Central), and without a significant increase in public spending. In addition, contrary to the 1990s after the Plano Real, external and public accounts are balanced and stabilized.

However, acknowledging these facts, the authors seem pessimists about the growth prospects of Brazil on this basis. So, they suggest a temporary softening of the orthodox policies, particularly of the monetary policy, in order to promote growth (and consequently, to attain some social objectives). This way would probably lead to the emergence of a new vicious circle: more inflation – low rising prices is a relatively recent phenomenon in Brazil -, and, later, tough measures to combat it again and a general return to economic and financial instability, including slow growth or even worse, and unemployment. On the contrary, with less inflation and the appreciation of the real as it happened throughout most of 2005, there will be more room for cutting interest rates and to implement other measures that stimulate growth.

With respect to public expenses, a priori, it will be better to rationalize rather than to increase them (such an increase without cover would lead to more public debt, and consequently, to more non-discretionary expenses, etc.).

In my view, in the long run, it is preferable to have a coherent model that creates conditions for sound and sustained growth than to play a game of "stop and go", with the policymakers basically concentrated in short-term macroeconomic objectives. The latter situation would mean, in fact, stagnation.

4. In the 2000s, the respect of fiscal and monetary orthodoxy, as it is, at another level, the voicing of freer trade by Brazil and other countries of the region (at least, in comparison with the USA and EU) are a positive turn in the mentality of Latin American policymakers, no matter their political origin. Nevertheless, it is worth noting, that even some of these policymakers got influence, as it happens in the Brazilian case, their position is weak because these policies are perceived as unpopular and there is a strong preference, for example in the media, for visible short-term effects. Also, the support of the Brazilian business community must not be exaggerated; illustrative of this is the fact that Vice-president José Alencar, a businessman by profession, has frequently and strongly voiced against “high interest rates” and other policies of the government. On the other hand, many employers are State dependent

through public orders and there is, in the existing context, important restraints at this level. Multilateral institutions may approve, but, as remarked below, they are not in deep touch with the local situation. Last but not least, there is even considerable division among economists about this issue.

After the expected failure in the 1990s of the models inspired by the so-called "Washington Consensus", a possible development for Latin America is the emergence of a peculiar equilibrium. Fortunately, authoritarian regimes no longer rule Latin America, democracy, perhaps imperfect in some cases, guides the majority of the countries and the people may choose their governments. In the absence of clear results of many elected governments of the 1990s, sometimes influenced by moral hazard considerations, the voters opted for parties and personalities with language close to them. This may represent some risks, but the existence of some local policymakers that respect economic fundamentals and have credentials in this sense, is a good anchor to avoid an evolution to the worst and a step backward in the liberalization process.

Political considerations also matter, and, likely, Labor governments may be quite appropriate to manage reforms with social costs (for example, taking into account their close ties with the trade unions). In the achievement of social measures, more than blatant ideology, structural reforms actually needed by the Brazilian economy, as was the case of social security reform described in the paper, are a much wiser step in a long run perspective, regardless of a momentary bitterness of radical supporters. This means that a wider scope, including not only economic but also political considerations, helps us to understand all that is at stake in these experiences.

Summing up, the Latin American governments that opt for orthodox policies aiming at a later achievement of broad social objectives, must keep them (as is the case for free trade and integration in the world economy), even if they are advised otherwise. Taking China and India as examples, they are rapidly growing and opening up to the world economy but, at the same time, they essentially respect macroeconomic fundamentals (i.e., consumer prices in 2005 up to October, percentage change on year ago, grew, respectively, 1.2% and 4.2; The Economist). The former group of countries, however, must creatively use the policies they adopt. In the circumstances of the Brazilian case just analyzed, this means that at a later stage, when credibility is consolidated, the government may be more flexible in its monetary and budgetary measures. More generally, for countries aiming at more income equity in the course of their development, such a sequence may provide, in the long run, the way for a sustained growth that benefits all its population (in Latin America and elsewhere).

5. In any case, I do not say that the Lula's experiment will succeed, even if there is a continuation of its specific solution - the electoral calendar of 2006 may eventually imply changes - for the trade-off between orthodox measures and the implementation of social reforms in the chosen sequence. There is always a problem of good management and supervision of all the process. If other dimensions, particularly at the political level (e.g., the problem of “mensalão” and its shock waves), gain ground over the rest, we should be able to make a distinction between the economic and the political administration of this Labor government, where the former represented a different and promising path about how to tackle the dilemma between orthodox policies and the implementation of social reforms.

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